

DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FILE B-174839**DATE:** January 28, 1983

MATTER OF: Navy Industrial Fund: Obligations in connection
with long-term vessel charters

- DIGEST:**
1. The Antideficiency Act, 31 U.S.C. § 1431, would not prevent the Navy from entering into the TAKX long-term ship leasing program, to be financed through the Navy Industrial Fund, so long as the unobligated balance of the Fund is sufficient to cover the Government's obligation until commencement of the lease period. Navy may not, through acceptance of vessel delivery, agree to commencement of the lease arrangement if the obligational availability of the Fund is at that time insufficient to cover any consequential increase in the Government's obligation.
 2. Under the Navy's TAKX ship leasing program, ship charters will cover a base period of 5 years, renewable up to 20 years at 5-year intervals, and with substantial termination costs for failure to renew. Such contracts, once in effect, should be recorded as firm obligations of the Navy Industrial Fund at an amount sufficient to cover lease costs for the 5-year base period, plus any termination expenses for failure to renew.

By letter dated December 2, 1982, the Comptroller of the Navy requested our opinion as to the proper manner in which to record certain obligations of the Navy Industrial Fund, in connection with two Military Sealift Command programs to build/convert and charter TAKX Maritime Prepositioning Ships and build and charter T-5 Tankers.

The question as originally presented related to the manner of recording termination expenses under the charter contracts. While we shall address that question below, it has become clear from our discussions with Navy officials that their principal concern is with the total amount that should be presently recorded as a firm obligation of the Government under the TAKX program. As is explained in detail below, it is our view that the Navy must record the TAKX program as a firm obligation only to the extent of the Government's maximum potential liability prior to commencement of the initial lease period. Once the Navy, through acceptance of vessel delivery, agrees to commencement of the lease, it must record the TAKX charter

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agreements as firm obligations in an amount sufficient to cover lease costs for the base period, plus termination expenses.^{1/}

BACKGROUND

Under the TAKX program, vessels are constructed or converted to meet military requirements and are subsequently time-chartered to the Military Sealift Command. The program consists of 13 vessels, provided by three different contractors. The Navy enters into two different agreements with each contractor: an Agreement to Charter and a Charter Party. The Agreement to Charter binds the Government until it accepts delivery of the TAKX vessels (in about two years, we are told). The Charter Party is the actual charter agreement, setting out the rights and responsibilities of the various parties throughout the lease period. Although both contracts are signed at the same time, the Charter Party does not become effective until the "Commencement Date," the date of the Government's acceptance of delivery of the vessels.

Once effective, each Charter Party provides for an initial hire term of 5 years following the construction period, with options to renew for four consecutive 5-year periods. Failure to exercise such options subjects the Government to substantial termination expenses. The capital hire rate during the entire 25-year term of the initial and optional charter periods is computed to repay to the equity bondholders and the owners the full value of their investments, plus interest. The Government may terminate the charter at the end of any 6-month period after the initial 5-year base period, but is thereby subject to termination expenses. Termination expenses are calculated to pay the outstanding principal and interest on the bonds, and to return to the owners their investments plus a rate of return to the date of termination (the "termination value"), less the proceeds of any sale of the vessel (or insurance proceeds in the case of a loss).

^{1/} We do not here address the more fundamental question of whether the Navy Industrial Fund is a proper source for funding such long-term lease arrangements. As we approved the use of the Fund to finance similar contracts in our decision 51 Comp. Gen. 598 (1972), we would not object to the TAKX program on that basis. Nonetheless, this issue will be reexamined by this Office in an upcoming in-depth review of the practice of obligating the Federal Government for multi-billion dollar programs such as the TAKX Prepositioning Ship Program through the use of Industrial funds. See H. R. Rep. No. 943, 97th Cong., 2nd Sess. 48-49 (1982). Similarly, we do not here address the wisdom of long-term leasing, as opposed to purchase, of TAKX vessels.

The Navy's concerns about recording obligations under the TAKX program arise from the fact that current available resources of the Navy Industrial Fund are sufficient to cover only about \$2.2 billion of new obligations. Thus, if the Navy must record firm obligations for the 13-ship TAKX program in excess of that amount, it would be necessary to scale-back the program to avoid a violation of the Antideficiency Act. The Antideficiency Act provides that:

"An officer or employee of the United States Government or of the District of Columbia government may not--

"(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation;
or

"(B) involve either Government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law."
31 U.S.C. § 1341(a)(1), recodified from 31 U.S.C. § 665(a) (1976).

DISCUSSION

I. Current TAKX Program Obligations

As indicated above, two contracts govern the Navy's obligation under the TAKX program. The first, the Agreement to Charter, is effective upon its signing: it obligates the Navy to accept delivery of vessels conforming to the specifications of the contract. Although the Navy may terminate for convenience at any time prior to accepting delivery, it would be required to pay any amount of basic capitalized costs incurred by the Shipowner up to the date of termination. The second contract, by comparison, is entirely contingent upon completion of the first. The Navy's obligation under the Charter Party agreement does not commence until it has accepted delivery of the TAKX vessels. Termination of the Agreement to Charter would simultaneously terminate the Charter Party, with no additional liability on the part of the Government.

Because the Navy's obligation under the Charter Party will not commence until it has accepted delivery of the TAKX vessels, it is our view that the Navy is not required to record a firm obligation under that contract until the contract becomes effective. Nevertheless, until the vessels are delivered there is, through the Agreement to Charter, a contingent liability, based on the possibility

that the Government will in fact be bound by the Charter Party. That potential liability, however, is limited by the Navy's own power to terminate the Agreement to Charter at any time prior to delivery. In our opinion, therefore, the Navy should record an obligation in an amount sufficient to cover its maximum potential liability prior to acceptance of the TAKX vessels. As we have been informed by the Navy that the current unobligated balance of the Navy Industrial Fund is sufficient to cover this obligation for all 13 TAKX vessels, we do not consider the Antideficiency Act to be a bar to the Navy's present program. We would caution, however, that once the delivery of vessels is accepted by the Navy, any new obligation, based on the terms of the Charter Party, may not exceed the unobligated balance of the Fund at that time.

II. Recording of Charter Party Obligations

As mentioned above, the question initially raised by the Navy related to the manner in which Charter Party termination expenses should be considered for purposes of recording obligations of the Navy Industrial Fund. While Charter Party obligations need not be recorded until the Navy accepts delivery of the TAKX vessels, there is some concern on the part of Navy officials that the unobligated balance of the Navy Industrial Fund may at that time be insufficient to cover all obligations, particularly if the Navy is required to include charter termination expenses. To avoid overobligating the Fund, the Navy has proposed to record as firm obligations under TAKX Charter Parties only the lease amounts due during the 5-year base period. Any additional expenses (i.e. termination costs after the base period) would not be recorded as firm obligations, but would be treated as contingent liabilities, shown as footnotes to the financial records of the Fund.

The Navy has argued that its proposed treatment of TAKX Charter Party termination expenses is consistent with title 2, section 13 of our Policy and Procedures Manual for Guidance of Federal Agencies, which describes the types of liabilities to be recorded as obligations. Subsection 13.2 of the Manual provides that contingent liabilities need be recorded as expenses only to the extent it is

probable that a liability will be incurred and its amount reasonably estimated. Otherwise, as is indicated in our decision 37 Comp. Gen. 691, 692 (1958), contingent liabilities may be shown as footnotes to the appropriate financial statements.

Having examined the contracts in question and the proposed treatment of termination expenses, we cannot agree that those expenses may be shown as footnote items. We recognize that these specific expenses are technically "contingent" in that they will arise only upon the happening of one of several events (for example, failure to renew, termination for convenience of the Government, or loss after delivery). If none of the contingent events arises, however, the Government will have a substantial alternative obligation. A principal example would be the continuation of the charter through the Navy's exercise of the renewal option. Renewal by the Navy would at that time create a new obligation to pay lease costs for the second 5-year period, plus termination expenses (unless, of course, the second renewal option was in turn taken). This process of replacing one obligation with another would continue throughout the full 25-year period, with the unliquidated obligation at each renewal period (i.e. the termination cost) being replaced by that created by continuation of the contract.

It is probable from the nature of these contracts that the Navy will choose to renew at each 5-year period. Nonetheless, any new obligation created by continuation of the contract will in fact exceed termination expenses after the 5-year base period. Whether the contract is continued only for one additional 5-year period (including termination costs) or up to the full 25 year lease term of the charter (at a cost over that period of about \$13 billion, we are told), the total expense to the Government of continuing the lease past the initial base period will be more costly than termination. It is our view, therefore, that each Charter Party, once in effect, should be recorded as a firm obligation to pay lease costs for a 5-year base period, plus termination costs after that time. This would represent the least amount for which the Government will be liable under the contract. See 48 Comp. Gen. 497, 502 (1969), in which we stated in the context of revolving funds that we would have no objection to contracting for a basic period with renewal options, provided that funds were obligated to cover the cost of the basic

period, plus any charges payable for failure to exercise the options. 2/


Based on the above, it appears that the Navy may be precluded from accepting delivery of (and thereby chartering) all 13 ships under the TAKX program, unless the obligational availability of the Navy Industrial Fund is increased in some manner. There are several ways that this might be accomplished. One would be by the direct infusion of funds through appropriations, or by transfers from other Defense Department accounts. Another way would be through enactment of specific "contract authority" for this program (specific authority to contract in excess or advance of appropriations). See, e.g., 56 Comp. Gen. 437, 444 (1977). Finally, the Navy might ask the Congress for specific statutory authority, at least for this particular program, to include anticipated reimbursements from future orders as budgetary resources of the Navy Industrial Fund. The Department of Defense has previously stated that it already has such authority with respect to its Industrial funds. We do not share this view. See our report "The Air Force has Incurred Numerous Overobligations in its Industrial Fund," AFMD-81-53, App. III, August 14, 1981.

CONCLUSION

Based on the foregoing, we have no legal objection to the Navy's TAKX program, so long as current obligational availability of the Navy Industrial Fund is sufficient to cover the Government's present obligation, that is, until the Navy, through acceptance of vessel delivery, agrees to the commencement of TAKX leases. Once TAKX

2/ In 51 Comp. Gen. 598, 604 (1972), we sanctioned an arrangement very similar to the present one, and in so doing, distinguished 48 Comp. Gen. 497 (1960). Our 1972 decision, however, did not reflect a different view of the types of commitments that must be recorded at the time that a contract becomes effective. Instead, we distinguished 48 Comp. Gen. 497 (1960) on the basis that the Navy had no need to rely solely on cash reserves of the Navy Industrial Fund in order to cover its obligations under the lease program. In 1972 we were persuaded that sufficient budgetary resources were available to cover all obligations under the program through exercise of the Navy's authority to transfer funds from other sub-accounts of the Navy Industrial Fund, or from other working capital funds. In the present case, however, the Navy is unable to assure us that it would be able to cover all TAKX Charter Party obligations in this manner.

charter agreements become effective, the Navy must record such agreements as firm obligations of the Fund to the extent of lease costs for the 5-year base period, plus any termination expenses for failure to renew. The obligational availability of the Fund must at that time be sufficient to cover any increase in the Government's obligation by reason of commencement of the lease period.

for 
Comptroller General
of the United States